Whiskey and America: A post-prohibition reunion (Fortune, 1933)

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Editor's note: Every Sunday, Fortune publishes a favorite story from our magazine archives. This week, we turn to a November 1933 series on whiskey, a spirit whose American roots run quite deep (founding father George Washington had a very successful distillery business in Mount Vernon, Va.). As the end of the U.S.'s 14-year prohibition period neared, a dormant beverage industry faced considerable challenges. How could it ramp up production to satisfy demand? What exactly was that demand? And how had tastes changed after 14 years of bootlegging? Today, American whiskey -- particularly rye -- is in the midst of a renaissance, with more craft distilleries setting up shop every year. And the U.S. spirits industry's revenues (which includes whiskey along with beverages like rum, vodka, and gin) were $20.4 billion in 2011, a 67% increase from 2001, according to data from the Distilled Spirits Council of the United States.

Newest U.S. business, oldest U.S. problem. The companies which will run it and the conditions under which it will be run. Such a subject needs a preface. This is it.

Fourteen years, five months, and approximately four and one-half days after it began on the wild midnight of June 30, 1919, national prohibition will end sometime between nine and five o'clock on December 5, 1933. Because the Supreme Court has held that "it is approval by the requisite number of States, and not proclamation, that gives validity to an amendment," the Eighteenth Amendment will be repealed when the second of three constitutional conventions which meet upon that day has ratified the Twenty-first Amendment. It will be ironical if the thirty-sixth state is Ohio, where in 1874 the W.C.T.U. and prohibition were simultaneously conceived, but it may as likely be Mormon Utah or the old rye-distilling state of Pennsylvania: Anyway, prohibition will end the fifth of December.

On that day, the Volstead Act will become null and its kindred laws void and the rusty legal machinery of fourteen years ago will begin to grind again. On that day, the manufacture, transportation, and sale of intoxicating liquor will be permitted in twenty states where live almost exactly half of the 123,000,000 inhabitants of the U.S. On that day, a billion-dollar industry will have a rebirth for which it has been feverishly and confusedly preparing these past nine months.

It is not strictly accurate to say that the liquor industry will be reborn. The U.S. has already had two liquor industries; the one which is gestating now and will come to life December 5 is the third of the dynasty. It resembles each of its predecessors in many respects; it differs from both in many. The first liquor industry was a whiskey business, the second an alcohol business. The third will be both. Its character will be shaped partly by legislation, partly by its own self-conscious character building, mostly by the economic law of supply and demand.

The demand is not hard to estimate in quantity. Before prohibition, the U.S. drank 140 million gallons of liquor a year. During prohibition, it drank not less than 200 million gallons. The demand, then, will be for at least 200 million gallons the first year. Two hundred million gallons of what?

Statistically the answer is easy. In 1913, the U.S. consumed (in millions of gallons):

- Native whiskey (rye, bourbon): 135
- Scotch (plus a little Irish): 1.5
- Gin: 5
- plus an insignificant amount of brandy and rum, plus an insignificant amount of champagne and other wines, liqueurs, and things like that.

But it must not be supposed that such statistics will answer the question for 1934. The second liquor industry, the bootleg industry, discovered that the one thing prohibition prohibited was the manufacture of the native U.S. drink, rye and bourbon whiskey, and so it gave the thirsty citizens something else and changed the taste of a generation.

The calculation of the taste factor now baffles everyone in the business. Before prohibition, gin went into Martinis and Negroes. The alcohol industry of the 1920s made it a drink. The younger drinking generation was weaned on it and an entirely new body of drinkers, women, preferred it to whiskey, possibly because it is reputed to contain some of the medicinal properties of essence of peppermint and Lydia E. Pinkham's vegetable remedy. Furthermore, gin can be sold more cheaply than even the worst whiskey. Two classes of businessmen are confident that during the first year of repeal as much gin will be sold as whiskey: they are the officials of the alcohol companies (U.S. Industrial Alcohol, Commercial Solvents, American Commercial Alcohol, Publicker, etc.) and the bathtub chemists.

Taste may have changed in another direction. Nobody knows how much the U.S. has grown up since there were iron deer on the lawns, but it has certainly become more sophisticated. And some optimists think that now that the sophisticated generation has asserted itself in a fourteen-year gin spree it will settle down to a mature appreciation of the finer qualities of alcohol. And alcohol is at its finest in wine. Except for the best vintages of Bordeaux and Burgundy and some of the Rhine wines, California's grape can hold up its head in any company. California could supply enough wine to make the U.S. as much a wine-drinking country as France. And do not forget that when tariffs are being considered California's persuasive Mr. McAdoo will be close to the Rooseveltian ear.

And there are other possibilities. Rum, for instance. Back in the days when there was no U.S. whiskey business, silk-legged gentlemen used to order their casks from the West Indies; their great-grandsons may do the same thing if whiskey is scarce, bad, or expensive. Rum makes a fine hot drink, a fine cold drink, and is not so bad from the neck of a bottle.

That leaves whiskey, of which there are three categories: U.S. whiskey (rye and bourbon), Scotch whiskey (plus a little Irish), and Canadian whiskey (rye and bourbon). Except in special cases, Canadian whiskey is out of the picture because it is the same stuff as U.S. whiskey, and handicapped by a tariff. Scotch is different. During prohibition not only was almost all good whiskey Scotch whiskey, but the Scotch taste could be imitated with alcohol and flavoring. Hence the consumption of Scotch and near-Scotch was far greater than the picayune million and a half gallons of the old wet days. There are, in the British Isles, 100 million gallons of Scotch that can be shipped to the U.S. Against it stands a tariff of $5 a gallon (which may be raised) and a trifling freight cost. Otherwise it starts even with U.S. whiskey.

Therefore the answer to the question, "What will the U.S. drink next year?" is: everything. It will experience no shortage. It may have to drink more gin than whiskey, but not for long. Its middle classes may exhibit a new gentility and, for the first time in U.S. history, wine may be a serious business. And its working men may have sense enough to stick to beer. But the core of the whole matter is whiskey. As a social problem, because whiskey is the preferred method of getting drunk. And as a business problem because whiskey, unlike gin, takes capital to produce and a great deal more capital and a great deal more organization to distribute, by brands, successfully.

The pre-prohibition whiskey business wound up its affairs with a surplus of 64 million gallons. Prohibition drank up all but four million gallons of it. Evaporation reduced that to less than three million gallons, and upon that three million the new U.S. whiskey business in its present corporate form has been feverishly erected. Since government permits for the distillation of new whiskey from 1929 until a few months ago were based upon possession of existing stocks, ownership of that old whiskey was not only an asset but a license. By last summer there had been distilled some 10 million gallons of newer whiskey, and then, with repeal in the offing, there began a mad scramble for whiskey that first drew the public's attention to the liquor business and culminated in the stock market's flurry and inevitable crash. Since then the liquor business has concentrated on corporate setups and alliances -- and another seven million gallons have been distilled. There are now 20 million gallons of whiskey in the U.S. and it is apportioned approximately as follows:

- National Distillers Products Corp: 10,000,000
- Schenley Distillers Corp: 5,000,000
- Scattered: 5,000,000

These amounts merely qualify their owners to start in the race for the U.S. whiskey business. Against a demand for hundreds of millions of gallons in the next few years, 20 million gallons is insignificant. How can it be stretched?

Suppose we glance hastily at the pre-prohibition whiskey business. Most of the whiskey that was drunk was blended and rectified (mixed with other whiskey and with alcohol and water and some kind of flavoring -- sherry, brandy, rum, prune juice, anything). Maybe one-fourth of it was whiskey, maybe less. It was this technique of the pre-prohibition whiskey men that the bootleggers borrowed and, more precise in their diction, termed cutting. And so the post-prohibition whiskey men can stretch their supply. One part whiskey to four parts of alcohol and water will make a drink that might not satisfy a Kentucky Colonel but will be plenty good enough for you. One part whiskey to nine parts of alcohol and water will make a pretty good beverage. And two or three gallons of good old whiskey plus a couple of gallons of new whiskey plus forty-five gallons of alcohol and water will make a barrel of drinkable liquor, although it might also make you belch. The gentlemen of the whiskey business will not hesitate to cut their whiskey, and until production catches up the whiskey business is liable to be pretty much a wholesale application of bootleg methods. Nevertheless, there is enough to go around.

There is the first danger: that the whiskey may be cut too much. But every company in the whiskey business has brand names; many of them are famous old names and their owners want to protect them. Under them will be sold the finer blends and the rare old pre-prohibition whiskey that may never be seen again. Upon the extent to which the whiskey business can resist the temptation to make immediate killings, upon the extent to which it is willing to establish the integrity of its brands, will depend not only the relative position of the present companies two years from now but the esteem in which the whole business is held.

The problem is only partly one of production. And production is the lesser part because at the rate new whiskey is being distilled (3,500,000 gallons per month) it will not be more than a year or two before the U.S. has all the potable rye and bourbon it wants. The major part of the problem before the whiskey companies is one of merchandising.

It is merchandising that will make or break National Distillers -- and to a lesser extent the other whiskey companies. For only through expert merchandising can the whiskey business be kept in relatively few hands -- few enough for the government to see that they are kept clean -- and if the business disintegrates into many small businesses it is in danger of becoming corrupt and inviting the strong purge recommended by Mr. John D. Rockefeller Jr. -- that it be put on a non-profit basis. The gentlemen of National Distillers, Schenley, et al. are aware of that danger and they will try hard to avoid the evils of the past.

In the old days, there were a couple of thousand companies and individuals in the whiskey business. There were the distillers and the blenders and the rectifiers and the brokers and the wholesalers and the drummers and the rest. The basic commodity was not whiskey but warehouse receipts for whiskey. These the distillers sold as soon as the whiskey was barreled and what became of it afterward was none of their affair. For none of the evils of the whiskey business, except the evil of bad management, were the distillers responsible. (With a few individual exceptions, most notorious of which was the case of "Puntang" whiskey, made in Indiana, advertised as an aphrodisiac, consumed in large quantities by truck drivers, bellhops, etc.) The other people in the whiskey business were responsible for the unreliability of labels and the uncertainty of quality. But for the most glaring evil, the evil that prohibitionists harped on -- gentlemen, the evil of the saloon -- not even the disreputable people in the whiskey business were directly to blame. The offenders were the brewers.

They owned, or had some very real interest in, 90 per cent of the saloons. Therefore the brewer got paid for his beer on time or it was too bad for the saloon keeper. The whiskey man had to wait. With the brewer standing over him demanding his pay the saloon keeper had to force sales. Hence the practice of giving credit to a customer and taking it out of his pay check on Saturday and sending him home to his poor wife plastered. Whether the profit was in beer or whiskey depended on the location of the saloon, but always it was the brewer who stood behind the temperance people's picture of the ogreish old bartender with the long mustaches and a bottle of whiskey in his outstretched hand. Actually, as everybody knows, all bartenders are very fine fellows who listen to your troubles and send you home in a cab.

Well, now, the brewers have reformed and the whiskey business is concentrated in a few hands, and if it can solve the problem of merchandising, everything will be lovely for National Distillers and Schenley and the others in the field, and very much lovelier for the public. National Distillers and the rest have just scratched the surface of their merchandising problem, but in their favor stand all the business methods developed during the 1920's -- national distribution of nationally known brand names pushed by national advertising, all backed by a large corporate technique. Against them stands a condition peculiar to the whiskey business, which they will have a hard time to overcome. A hundred million gallons costs $50,000,000 to make; that $50,000,000 is tied up until the whiskey is sold. Neither National Distillers nor Schenley nor any other company has the capital to carry two or three years' supply. So maybe they will have to sell warehouse receipts and plunge the industry into chaos. Perhaps they can solve the problem. If they can, the U.S., with the whole whiskey business starting afresh, should be capable of producing within two or three years an industry confined to twenty or thirty responsible units rather than to two or three hundred irresponsible ones.

If it uses its opportunities wisely, the U.S. whiskey business should be able soon to dominate the domestic field. Against imported liquor it has the advantage of a $5-per-gallon tariff, and with the Administration determined to increase grain consumption this tariff is quite likely to be raised. Against gin it has the advantage of quality, the disadvantage of price. But here again the government will help. The present excise tax is $1.10 a gallon on all liquor. It will not quite produce the $250,000,000 the Administration has promised to raise by liquor taxation and Congress is very likely to raise the tax anyway. And so the higher it goes, the less inequality will exist between the price of gin and the price of whiskey. Against the bootlegger it has national, state, and local officers fighting tax evaders and not public benefactors. The dry states will have their bootleg problem, but where liquor sales are licensed, the police will protect the places that pay the fees that pay their salaries on pay day. And people are suddenly going to become conscientious on December 5.

As for prices, Park & Tilford is currently asking $40 a case for Scotch, of which $15 is tariff and tax. Scotch can be landed in New York for $10 a case and so Park & Tilford is getting a 60 per cent markup. If the tariff goes up, the markup will probably come down and Scotch will still be around $40 a case. Which is less than $3.50 a bottle. U.S. whiskey, to compete, must be sold for $2.50 a quart. And gin, to compete with that, for $1.50 a bottle. These prices seem high. They are. They will be down.

http://features.blogs.fortune.cnn.com/2012/06/24/whiskey-prohibition-fortune-1933/?section=magazines_fortune